



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

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Legend:

Date1 =

Date 2 =

Date 3 =

Foundation =

Association =

Museum =

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City =

Management =

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Dear ,

Facts:

This letter is in reference to the letter of Date1, as amended, from the authorized representative of Foundation. As amended, Foundation is requesting four rulings respecting certain issues arising under §§ 501(c)(3), 512, 513, and 514 of the Internal Revenue Code.

Foundation is an organization recognized by the Internal Revenue Service (Service) on Date 3 as exempt from federal income tax under § 501(c)(3), and was originally determined to be not a private foundation within the meaning of § 509(a) because it was described in § 509(a)(3). Foundation was a supporting organization of only one supported organization, Association. Association is a membership organization for m coaches at the collegiate and high school levels. It is recognized as exempt from federal income tax under § 501(c)(6). On Date 2, Foundation's public charity status was modified to §§ 509(a)(1) and 170(b)(1)(A)(vi). Foundation states that it was formed at the behest of Association to carry out charitable activities, from time to time, of interest to Association and its members.

Foundation states that its primary activity is operating Museum. Museum is located in the heart of City, adjacent to and connected with a new multi-purpose sports arena. Museum is a centerpiece in efforts that are being made to rejuvenate City central area. The mission of Museum is to educate and inform the public about amateur m and m coaching, and their history, and to inculcate in the public the values inherent in certain character traits. Foundation hopes that visitors to Museum, through contact with its interactive displays, will acquire increased knowledge and appreciation for the game of amateur m (particularly men's college m), its rich heritage and tradition, and the values and life lessons that it teaches.

Foundation states that Museum building is owned by City. City delegated the management of both the sports arena and Museum to a development/management company, Management. Foundation built Museum in Museum building and operates Museum under a contract with Management. Under this contract, Foundation does not pay rent either to Management or City, but Foundation is responsible for all Museum operating expenses and capital improvements.

The funding necessary to construct Museum came from a variety of resources including a grant from City that was financed through bonds issued by City, private donations, and loans from City and a private banking institution. With respect to the loans, City loaned Foundation money with an interest rate of percent, which is due to be paid no later than years after the date the loan was made. The bank provided a -year line of credit bearing an interest rate of percent. Foundation drew on the line of credit in order to complete construction of Museum. Other than repayment of the loans owed to City and the bank, Foundation does not have any outstanding debt related to the construction and improvement of Museum. Foundation states that it is not required to repay the grant received from City.

Foundation states that it rents Museum to businesses, clubs, and other groups and individuals for business meetings, retreats, weddings, parties, and other private events. During Foundation's 2008 through 2010 fiscal years, Museum was available to the general public from 83 to 89 percent of the time it was open, and was available to private parties from 11 to 17 percent of the time it was open.

Foundation states that it provides a lounge and snack bar in Museum allowing patrons to watch college m games on television sets located throughout the area. Visitors can purchase drinks and snacks from several vending machines located in this area. Foundation is entitled to receive a percentage of the price for each item sold from the vending machines. The percentage varies depending on the product sold. The vending machines themselves are owned by an unrelated third party who is responsible for making sure the vending machines properly work and are stocked with food and drink.

Foundation states that it has entered into a licensing agent agreement (Licensing Agreement) that grants authority to a third party to act as agent on behalf of Foundation in licensing the trademarks owned by Foundation. The agent has the exclusive right under the Licensing Agreement to develop a public relations, advertising, and marketing program for Foundation's trademarks and to implement a plan using third party licensees to commercialize, license, and/or sell various products or services which bear or otherwise incorporate

Foundation's trademarks, except in City, and the area within a -mile radius of City. As part of the Licensing Agreement, the agent negotiates on behalf of Foundation the business terms and conditions of agreements between Foundation and any third party licensee, who is subject to the same restrictions as the agent on the use of Foundation's trademarks. The terms of an agreement entered into between Foundation and a third party licensee varies depending on the agreement reached among the parties. However, in general, the payments received by Foundation from the agreements for the use of its trademarks are based on either a percentage of the gross sales of the licensed products or services using Foundation's trademarks or a flat sum that is paid on at least an annual basis. The agent collects the amounts due from the third party licensees and then remits the amounts collected to Foundation. In addition, Foundation is not required to provide any goods or services in connection with any agreement entered into with a third party licensee. The Licensing Agreement provides Foundation with the right of final approval as to any particular arrangement with a third party licensee, including the terms and conditions of such arrangement. Also, the agent is required to review each third party licensee's use of Foundation's trademarks, including (if necessary) visiting a third-party licensee's manufacturing facilities, to insure the quality control of Foundation's trademarks. In exchange for receiving these services, Foundation has agreed to pay the agent a percentage of the gross revenues collected from the third party licensees.

Foundation states that Management annually receives sponsorship payments from the initial sponsors (Founding Partners) of the sports arena. Foundation is entitled initially to receive \$x from these sponsorship payments from Management, with such amount increased by percent each year. This amount will also be increased by an amount agreed to by Foundation and Management for each new sponsor of the sports arena. Foundation also receives sponsorship payments from various colleges and universities in exchange for Foundation displaying each school's logo.

Foundation states that it receives sponsorship payments for and revenue from ticket sales to attend the annual honor induction ceremonies. Each sponsor's name and/or logo is displayed on signs, programs, and pamphlets associated with the ceremonies.

Foundation states that it is commencing a financial assistance program to benefit Association members, who are also coaches or retired coaches. Foundation states that it will provide financial assistance and may provide other assistance, such as crisis referral and counseling services, to Association members who have demonstrated financial or emotional need, including but not limited to need, due to job loss, serious illness, death of a family member, disaster, or other appropriate circumstances. Foundation states that it intends to pursue this program to the extent its human and financial resources permit it to do so. The program is particularly aimed at helping the members of the high school and college m coaching profession who suffer severe economic strain due to job loss. For example, Foundation states, when a college head m coach loses his job, all of the assistant coaches customarily lose their jobs as well. The head coach may get a lucrative buyout package or a severance package. The assistant coaches, however, normally get little or no notice that they are going to lose their jobs and receive few if any severance benefits. As a result, the assistant coaches in this kind of situation, which is not unusual, frequently encounter severe difficulty in meeting their living needs and paying their financial obligations. In this situation, even a modest amount of financial

assistance to the assistant coach might be quite meaningful to him and the members of his family.

Foundation states that Association currently has approximately _____ members, although the exact number changes from time to time. However, Foundation expects that this number will remain reasonably constant in the future. Foundation believes that the number of such persons who would meet the assistance criteria at any given time would likely be small. Foundation's financial assistance program will be set forth in writing and will include appropriate criteria to assure that assistance is provided only to individuals who are eligible members of the charitable class. Such criteria will include demonstrable financial or emotional need.

Foundation states that assistance will be granted by a committee established by Foundation consisting, at least in part, of persons with a social work or other relevant background, and less than a majority of the committee will, at any time, be individuals who are directors or officers or key employees of Foundation. No director or officer or key employee of Foundation, while serving in such capacity, or any family member of a director or officer or key employee of Foundation, while the director or officer or key employee is serving in such capacity, may be granted financial assistance by Foundation.

Foundation states that the amount of financial assistance that it is able to provide to any given recipient of aid will be determined by the committee. The amount of aid will vary from time to time depending upon Foundation's financial resources. Foundation states that the amount of aid that will be available to be given to any individual under the program is \$y, a relatively small amount.

Foundation states that Association will not in any of its membership literature characterize or tout or publicize Foundation's financial assistance program as a benefit of Association membership. Thus, the operation of Foundation's program will not confer upon or result in any benefit accruing to Association. However, in order to make potential recipients of assistance from Foundation aware of the program, at Foundation's request Association will from time to time include in Association's magazine, and in other materials disseminated by Association, basic information about the availability of assistance through the program. This information will make it clear that the program is operated by Foundation and will refer interested persons to Foundation.

Rulings Requested:

Specifically, Foundation is requesting the following rulings:

1. Foundation's status under § 501(c)(3) will not be jeopardized or adversely affected by the activities of the Foundation as described in this ruling request, including in particular Foundation's implementation and operation of its financial assistance program.
2. Museum is not debt-financed property under § 514.
3. Income generated by the vending machines in Museum is not unrelated business taxable income under § 512.

4. The payments received by Foundation pursuant to the Licensing Agreement are royalties within the meaning of § 512(b)(2).

Law:

Section 170(b)(1)(A)(vi) describes, in part, an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501(a)) from direct or indirect contributions from the general public.

Section 501(c)(3) provides for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, or educational purposes so long as no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 501(c)(6) provides, in part, for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, boards of trade, not organized for profit and no part of the net earnings of which inures to be benefit of any private shareholder or individual.

Section 509(a) provides, in part, that the term "private foundation" means a domestic or foreign organization described in § 501(c)(3) other than organizations described in §§ 509(a)(1), (2), (3), and (4). Section 509(a)(1) is defined as an organization described in § 170(b)(1)(A) (other than in clauses (vii) and (viii)).

Section 512(b)(2) provides that there shall be excluded from the definition of unrelated business taxable income all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property and all deductions directly connected with such income.

Section 513(a) provides, as a general rule, that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Section 514(a) provides for the taxation of unrelated debt-financed income in computing under § 512 the unrelated business taxable income for any taxable year.

Section 514(b)(1) defines the term "debt-financed property" as any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in § 514(c)) at any time during the taxable year.

Section 514(b)(1)(A)(i) provides that the term "debt financed property" does not include any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Section 514(b)(1)(B) provides, in part, that the term "debt financed property" does not include any property to the extent that the income from such property is taken into account in computing the gross income of any unrelated trade or business.

Section 514(c) defines the term "acquisition indebtedness," with respect to any debt-financed property, as the unpaid amount of (A) the indebtedness incurred by the organization in acquiring or improving such property; (B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and (C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Section 1.512(b)-1(b) of the Income Tax Regulations provides that royalties, including overriding royalties, and all deductions directly connected with such income shall be excluded in computing unrelated business taxable income. However, for taxable years beginning after December 31, 1969, certain royalties from and certain deductions in connection with either debt-financed property (as defined in § 514(b)) or controlled organizations (as defined in paragraph (1) of this section) shall be included in computing unrelated business taxable income.

Section 1.513-1(d)(1) provides, in general, that gross income derives from "unrelated trade or business," within the meaning of § 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question – the activities, that is, of producing or distributing the goods or performing the services involved – and the accomplishment of the organization's exempt purposes.

Section 1.514(c)-1(a)(1) defines "acquisition indebtedness," with respect to debt-financed property, as the outstanding amount of (i) the principal indebtedness incurred by the organization in acquiring or improving such property, (ii) the principal indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement, and (iii) the principal indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonable foreseeable at the time of such acquisition or improvement.

Section 1.514(b)-1(b)(1)(i) provides, in part, that to the extent that the use of any property is substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its charitable,

educational, or other purpose or function constituting its basis for exemption under § 501, such property shall not be treated as "debt-financed property." See § 1.513-1 for principles applicable in determining whether there is a substantial relationship to the exempt purpose of the organization.

Section 1.514(b)-1(b)(1)(ii) provides that if substantially all of any property is used in a manner described in § 1.514(b)-1(b)(1)(i), such property shall not be treated as "debt financed property." In general, the preceding sentence shall apply if 85 percent or more of the use of such property is devoted to the organization's exempt purpose. The extent to which property is used for a particular purpose shall be determined on the basis of all the facts and circumstances. These may include a comparison of the portion of time such property is used for exempt purposes with the total time such property is used.

Rev. Rul. 74-399, 1974-2 C.B. 172, describes the operation of a dining room, cafeteria, and snack bar by an exempt art museum for use by the museum staff, employees, and members of the public visiting the museum. The patronage of the eating facilities by the general public is not directly or indirectly solicited, and the facilities contemplated are not designed to serve as a public restaurant but merely to serve the exempt purposes of the museum. The facilities are not directly accessible from the street. The operation of the eating facilities within the museum premises helps to attract visitors to the museum exhibits. The revenue ruling holds that the operation of the eating facilities by the museum under the particular circumstances is substantially related to the museum's exempt purposes and consequently is not unrelated trade or business within the meaning of § 513 of the Code.

Rev. Rul. 81-178, 1981-2 C.B. 135, holds that payments an exempt organization receives from various business enterprises for the use of the organization's trademark and similar properties are royalties within the meaning of § 512(b)(2). The revenue rulings states that to be a royalty, a payment must relate to the use of a valuable right. Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not payment is based on the use made of such property, are ordinarily classified as royalties for federal tax purposes. Similarly, payments for as the use of a professional athlete's name, photograph, likeness, or facsimile signature are ordinarily characterized as royalties. On the other hand, royalties do not include payments for personal services. However, the revenue ruling states that the mere retention of quality control rights by a licensor in a licensing agreement situation does not cause payments to the licensor under the agreements to lose their characterization as royalties.

Analysis:

An activity carried on by an organization described in § 501(c)(3) that is "substantially related" to the exercise or performance of its exempt purpose, within the meaning of § 1.513-1(d), will not constitute unrelated trade or business under § 513a.

Foundation's financial assistance program is designed to provide modest financial benefits and services such as crisis referral and counseling to Association members who have demonstrable financial or emotional need, and who have suffered severe economic strain due to various circumstances, including job loss in particular. A committee of persons, consisting at

least in part of persons with social work or other relevant backgrounds, will grant the assistance. Less than a majority of the committee will be composed of directors or officers or key employees of Foundation. Association's members constitute a large and indefinite number or persons and are not considered to be a closed class. For these reasons, Foundation's financial assistance program is considered to be charitable within the meaning of § 501(c)(3).

Foundation used a variety of funding to construct Museum, including grants financed through bond issuance, private donations, and loans from City and a private banking institution. Other than repayment of the loans owed to City and the bank, Foundation does not have any outstanding debt related to the construction and improvement of Museum. Since such debt, however, constitutes "acquisition indebtedness" under § 514(c), Museum would be considered debt-financed property under § 514(b) unless an exception applied.

Under § 514(b)(1)(A)(i), the term "debt-financed property" does not include any property substantially all of the use of which is substantially related to the exercise or performance by an organization of its exempt purpose. Section 1.514(b)-1(b)(1) provides that "substantially all of the use" of a property is substantially related to exempt purposes if 85 percent or more of the property is devoted to the organization's exempt purpose. With regards to Foundation, Museum, the property for which Foundation incurred the debt, is generally available to the general public for more than 85 percent of the total time it is open. Therefore, comparing the portion of time the Museum is used for exempt purposes with the total time it is used, the facts show that 85 percent or more of the Museum is devoted to Foundation's tax exempt purposes. But even if Museum were open to the general public less than 85% of the time, Museum would still not be considered debt-financed property. Under § 514(b)(1)(B), "debt-financed property" does not include any property to the extent that the income from such property is taken into account in computing the gross income of any unrelated trade or business. Since the income from the rental of Museum to private parties would be taken into account in computing Foundation's gross income from unrelated trade or business, Museum would not be considered debt-financed property to the extent it is open for private events. Consequently, no part of Museum would be considered debt-financed property.

Pursuant to Rev. Rul. 74-399, supra, and under the circumstances presented, Foundation's income from its vending machines in Museum at times when Museum is open to the general public would be considered to be substantially related to Foundation's exempt purpose, and would not be considered as unrelated business income.

Pursuant to Rev. Rul. 81-178, supra, payments that an exempt organization receives from various business enterprises for the use of the organization's trademark and similar properties are royalties within the meaning of § 512(b)(2). In this case, the payments received by Foundation pursuant to agreements for the use of its trademarks are based on either a percentage of the gross sales of the licensed products or a flat sum paid on at least an annual basis. Foundation is not required to provide any goods or services in connection with any agreement entered into with a third party licensee. Foundation has the right of final approval as to any particular arrangement with a third party licensee, including the terms and conditions of such arrangement. Foundation's income in this manner is therefore considered to be royalties within the meaning of § 512(b).

Conclusions:

Accordingly, based on the facts and circumstances as stated above, we rule as follows:

1. Foundation's status under § 501(c)(3) of the Code will not be jeopardized or adversely affected by the current activities of the Foundation as described in this ruling letter, including, in particular, Foundation's implementation and operation of its financial assistance program.
2. Museum is not considered to be debt-financed property of Foundation under § 514.
3. Income generated by the vending machines in Museum at times when Museum is open to the general public is not unrelated business taxable income under § 512.
4. The payments received by Foundation pursuant to the Licensing Agreement are royalties within the meaning of § 512(b)(2).

These rulings are based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any changes that may have a bearing upon Foundation's tax status should be reported to the Service. Because it could help resolve questions concerning Foundation's federal income tax status, this ruling should be kept in Foundation's permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to Foundation's authorized representative.

Except as we have specifically ruled herein, we express no opinion as to the consequences of these transactions under the cited provisions or under any other provision of the Code.

These rulings will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

These rulings are directed only to the organization that requested it. Section 6110(k)(3) provides that they may not be used or cited as precedent.

If there are any questions about this ruling, contact the person whose name and telephone number are shown in the heading of this letter.

Enclosure
Notice 437

Sincerely yours,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2